M S R Public Power Agency

P.O. Box 4060 • Modesto, California 95352 • (209) 526-7436

August 31, 2012

Robert Weisenmiller, Chair
California Energy Commission
1516 - Ninth Street
Sacramento, CA 95814-5512

Re: 12-OIR-01

Dear Chairman Weisenmiller:

The M-S-R Public Power Agency[1] (M-S-R or Agency) offers the following response to the letter dated August 17, 2012 from the National Resources Defense Council and Sierra Club (NRDC/Sierra Club) requesting the inclusion of certain documents in the record of 12-OIR-01 (August 17 Letter). M-S-R does not object to including these documents in the record for this proceeding if the Commission is interested to learn more about how M-S-R conducts its business, meets its contractual obligations, and protects its members and bondholders with respect to its significant investment in the San Juan Generating Station (SJGS). However, M-S-R objects to the unsubstantiated and inflammatory allegations in the letter the Agency has acted improperly in any way. M-S-R also objects to the way in which NRDC/Sierra Club characterize the documents at issue, and appreciates this opportunity to provide the Commission with the correct information.

I. Introduction

First and foremost M-S-R takes extreme exception to the allegations of wrong-doing and the assertions that the Agency has done anything wrong. M-S-R has fully and timely complied with all Commission regulations, direction, and requests for information. NRDC/Sierra Club's characterization of the documents referenced in the August 17 Letter displays a fundamental misunderstanding of the way in which publicly owned utilities operate. As more fully explained herein, M-S-R has an ownership interest in the SJGS coal fired electric generation facility, and

1 M-S-R's members include the Modesto Irrigation District, the City of Santa Clara, and the City of Redding.

adoption of the emissions performance standard (EPS) regulation (Regulation) did not alter the Agency's ownership interest. Accordingly, M-S-R must look into all available options to comply with the federal mandate associated with the Federal Implementation Plan, and must protect itself, its members, and its bondholders from newly mandated projects and expenditures and financial impacts associated with them. The documents that NRDC/Sierra Club find "alarming" do nothing more than lay out processes that must be employed to protect M-S-R's legal interests in the facility, and the associated obligation to protect its members and bondholders. Each of the referenced documents specifically states that they **do not bind** M-S-R to make expenditures or commit to projects. Furthermore NRDC/Sierra Club continue to make presumptive and incorrect conclusions regarding the August 31, 2007, 06-OIR-01 Final Statement of Reasons (FSOR). To characterize environmental expenditures as "not routine maintenance" is not the same as characterizing all environmental expenditures as "covered procurements." It is this erroneous conclusion and its unfounded leap in logic that has further exacerbated NRDC/Sierra Club's misunderstanding of the documents and mischaracterization of the issues.

II. The Documents Submitted by NRDC/Sierra Club

a. Resolution 2011-10

Resolution 2011-10, adopted by the M-S-R Commission on September 28, 2011, is commonly referred to as a reimbursement resolution. Pursuant to Section 1-150.2 of the United States Treasury Regulations, M-S-R is required to adopt such a resolution in order to reimburse itself for certain expenditures made prior to the issuance of bonded indebtedness that are related to the item financed through the indebtedness. In other words, this is a mechanism that permits a public agency to finance certain costs of a project, even those that are incurred prior to the public agency obtaining financing to pay for the project or those incurred in preliminary investigations or evaluations prior to approval or acceptance of the proposed project. These types of resolutions are routinely adopted by public agencies contemplating a project that will be financed through debt. M-S-R has adopted a number of such resolutions over the years.

By its own express terms, Resolution 2011-10 is made solely to comply with the Treasury Regulations and does not obligate M-S-R to make any expenditure, incur any indebtedness, or proceed with the an environmental compliance retrofit project at the SJGS. In a nutshell, if M-S-R proceeds with a project that it finances through indebtedness, it will be able to finance the costs for that project which it incurred prior to incurring the indebtedness. The sole effect of the Resolution is to say, ***IF** M-S-R proceeds with a project and **IF** it finances that project with indebtedness, then, and only then, will it be entitled to reimburse itself for certain expenditures made prior to incurring the indebtedness.*

There is no legal obligation or need to make mention of the legal requirements of the EPS, nor to make cost estimates for reducing carbon emissions to meet the EPS in this

Resolution. Similarly, there was no requirement, reason or need to file these documents with the Commission, as they did not approve any expenditure in a non-EPS compliance facility.[2] Adoption of the Resolution is simply sound, prudent financial business practice that protects the interests of M-S-R's members and bondholders. Its adoption has no bearing whatsoever on whether an environmental compliance project is permitted by Senate Bill (SB) 1368. No one, especially the Commission, should be alarmed by the purpose, need, clarity, focus, simplicity and adoption of the Resolution.

b. Staff Report – September16, 2011

The Staff Report dated September16, 2011 prepared by the M-S-R General Manager provides the M-S-R Commission an explanation as to why Resolution 2011-10 is being presented to it for consideration and recommends its adoption. The Staff Report states that PNM, as Operating Agent of the SJGS, is acting according to Prudent Utility Practice to begin certain engineering and design activities to ready the SJGS for a Selective Catalytic Reduction (SCR) Project even though there has been no formal action to accept or approve the SCR Project. The Staff Report informs the M-S-R Commission that the Agency's bond counsel has recommended adoption of the Resolution so that any costs incurred going forward related to the "potential project" can be reimbursed from a future financing and is very clear in explaining that adoption of the Resolution does not bind the Agency to make any future expenditure, incur any indebtedness, or proceed with the SCR Project.

c. Staff Report – May 21, 2012

The Staff Report dated May 21, 2012 prepared by the M-S-R General Manager for the M-S-R Commission requests direction regarding the preparation of funding plans for a "potential" environmental compliance retrofit project for the SJGS. The Staff Report reminded the M-S-R Commission that it had previously adopted Resolution 2011-10 and informs M-S-R Commission that no decision has yet been made as to whether the Environmental Protection Agency (EPA) will require an SCR or Selective Non-Catalytic Reduction (SNCR) project for the SJGS. The M-S-R Commission is informed that its portion of the costs for an SCR project could reach $85 million and its portion of the costs for an SNCR project could reach $8 million. In

2 "The regulations clearly require every procurement that qualifies as a new ownership investment to be filed with the Energy Commission; thus, every appropriation for a covered procurement must be submitted to the Energy Commission in a compliance filing. Whether these are filed separately or together, they must be filed within 10 days of the POU entering the covered procurement. Based on comments made throughout this proceeding, it appears that a POU only officially "enters into" a procurement after its Board has voted to approve the investment and delegated authority to the City Manager or other authorized individual to sign the necessary documents. If the board approves the initial investment and specified successive appropriations, then the same should be included in the compliance filing. If the board only approves the initial investment and requires additional Board approval for successive appropriations, then the successive appropriations should be included in a compliance filing only after they have been approved by the Board." FSOR, p. 39.

order to plan and budget for a potential project, the General Manager recommends that "potential funding plans" be developed for either an SCR project or an SNCR project.

This Staff Report does not commit the Agency to any project at the SJGS or to fund any project at the SJGS. It is simply recommending a planning and budgeting process that provides a means for the Agency to comply with the requirements of pre-existing third party agreements such as the San Juan Project Participation Agreement and Bond Indentures, or obligations that may be required under Public Interest standards. It is simply prudent business practice.

III. NRDC/Sierra Club's Assertions and "Alarm" are Unfounded

In the letter, NRDC/Sierra Club claim that they have discovered documents as part of a data request[3] to M-S-R that must be brought before the Commission's attention, and that these documents are "alarming" for two reasons. As more fully set forth below, despite the fact that NRDC/Sierra Club claim to find the documents alarming, the basis for such an assertion is not premised upon any violation and their disjointed conclusion is wholly irrelevant in the context of reviewing the documents at issue.

a. NRDC/Sierra Club's First Allegation

First, NRDC/Sierra Club claim that the documents "make no mention of the legal requirements of the EPS and do not contemplate or make any cost estimates for reducing carbon to meet the EPS." (August 17 Letter, p. 1) This statement is altogether irrelevant to any discussions regarding M-S-R's responsibility to comply with the EPS for several reasons.

To begin with, the documents at issue address M-S-R's legal obligations vis-à-vis the SJGS and the federally mandated Regional Haze Federal Implementation Plan (FIP). M-S-R has a legal obligation to protect its investment in the SJGS, and **if** it is later determined that the required improvements can or cannot be made due to the EPS, M-S-R must have laid the foundation for recovering the associated costs, or risk exposing itself, its bondholders, and its members to catastrophic costs. The Staff Reports and Resolution do not ignore the EPS nor M-S-R's responsibility under the EPS. These documents are separate and apart from resolutions and actions associated with compliance with the state law and are a necessary and integral part of M-S-R's operations. The sole purpose of the referenced documents is to ensure that M-S-R is able to finance expenditures it may be mandated to make, and to ensure that any expenditures that may arise prior to the issuance of bonds could also be financed in a bond issuance. As is

3 In its August 17 letter, NRDC/Sierra Club make a point of noting that the documents were received more than 45-days after their initial request. Upon receipt of the June 20, 2012 request for documents, M-S-R immediately commenced gathering the thousands of pages of information that were contained in the request. Within nine days of the initial request M-S-R General Counsel first communicated with counsel to convey that M-S-R would respond to the request as required by law. Based on subsequent and ongoing discussions between M-S-R General Counsel and counsel for the Sierra Club, Sierra Club scaled back the scope of the original request, and on August 10, 2012, M-S-R provided the Sierra Club with a flash-drive that contained all of the requested documents.

clear after even a cursory reading of the documents, M-S-R did not approve, or commit to expend, any monies as part of the September 2011 Resolution. The September 16, 2011 Staff Report specifically references the fact that Prudent Utility Practice requires the SJGS operator to make diligent efforts to comply with the federal mandates, and that Bond Counsel has recommended that M-S-R take the necessary steps to secure reimbursement of any associated expenditures. Both the Staff Report and Resolution 2011-10 make clear that the actions discussed therein do not bind M-S-R to make any expenditure or approve any projects. "*This declaration is made* ***solely for purposes of establishing compliance with the requirements of Section 1.150-2 of the Treasury Regulation****. This declaration does not bind the Agency to make any expenditure, incur any indebtedness, or proceed with the Project*." (Resolution 2011-10, Section 2, p., 2, emphasis added.)

Furthermore, adoption of a reimbursement document such as Resolution 2011-10 is common practice among public agencies to protect the interests of members and ratepayers by allowing the amortization of review and evaluation costs associated with prospective procurements or projects *only if and when* such procurements or projects are consummated. For example, the Southern California Public Power Authority (SCPPA) has adopted three similar resolutions in the last few years. In each of these instances, the projects were either delayed for an extended period of time or did not come to fruition, and securities were never issued. SCPPA Resolution No. 2008-69 was approved for recapture of costs associated with the Imperial Valley Geothermal project, which has been in development for the past three years, and for which no securities have been issued. SCPPA Resolution No. 2009-26 was issued to capture the costs associated with the SCPPA Leaning Juniper 2 Wind project, however this project never proceeded beyond the preliminary development phase and SCPPA never issued any securities under this resolution. Similarly, SCPPA Resolution No. 2009-46 was approved for the SCPPA Raser 3 project, but as the project was never realized, no securities were issued. Like M-S-R Resolution 2011-10, these SCPPA resolutions were not adopted as part of a process that would approve the underlying project. These examples further demonstrate that reimbursement resolutions such as these are not part of the deliberative process regarding a determination on whether or not an agency will proceed with a referenced project.

Second, neither the EPS regulation, nor any other CEC regulation, requires M-S-R to make any cost estimates for reducing carbon emissions to meet the EPS. Regardless, when M-S-R addresses such options, it would do so as part of a totally separate agency action, and would not be included in a staff report or resolution concerning compliance with the Treasury requirements. The amount of any investment or expenditure is irrelevant to the determinations by either M-S-R or the CEC as to whether such expenditure is a covered procurement or not (Regulation, § 2901(d)).[4] It is the nature of the investment or expenditure, to wit whether it

4 In the FSOR, the Commission clearly stated that "a new ownership investment is 'any investment' that meets the criteria outlined in 2901(j)(1) through (4). If the investment satisfies any of these criteria, then it is considered a 'new ownership investment,' regardless of the size of the investment, and the POU must either obtain an exemption

exceeds the scope of routine maintenance **and** extends the life or increases the life of the baseload facility, which is determinative as to whether an investment or expenditure is a covered procurement. (Regulation, § 2901(j)(4), emphasis added.)

Third, NRDC/Sierra Club allege malfeasance on the part of M-S-R, and allege that M-S-R has approved covered procurements in violation of the EPS.[5] NRDC/Sierra Club attempt to support this allegation based on the position that because the FSOR stated that environmental improvements are not automatically deemed "routine maintenance," they are therefore covered procurements.[6] This position is simply wrong. Nowhere in the FSOR or the Tentative Conclusions does the Commission state that all environmental improvements are covered procurements. Rather, in the FSOR, the Commission laid out its reasoning as to why environmental improvements would not be outright exempted from the EPS mandate, and found that such improvements are not necessarily routine maintenance. The EPS regulations sets forth clear and distinct direction regarding what **is** a covered procurement.

Pursuant to Section 2901(d) of the Regulation, "covered procurement" means:

> *(1) A new ownership investment in a baseload generation powerplant, or*
> *(2) A new or renewed contract commitment, including a lease, for the procurement of electricity with a term of five years or greater by a local publicly owned electric utility with:*
>
> > *(A) a baseload generation powerplant, unless the powerplant is deemed compliant, or*
> > *(B) any generating units added to a deemed-compliant baseload generation powerplant that combined result in an increase of 50 MW or more to the powerplant's rated capacity.*

In Section 2901(j), the Regulation goes on to define a "new ownership investment" as:

> *(1) Any investments in construction of a new powerplant;*
> *(2) The acquisition of a new or additional ownership interest in an existing non-deemed compliant powerplant previously owned by others;*
> *(3) Any investment in generating units added to a deemed-compliant powerplant, if such generating units result in an increase of 50 MW or more to the powerplant's rated capacity; or*

---

or the subject power plant must meet the EPS." FSOR, p. 25.

5 To date, M-S-R has not made any procurement decisions regarding the federally mandated improvements, and indeed, the FIP is currently the subject of a 90-day stay issued by the Federal EPA; see *Stay of Effectiveness of Requirements; Approval and Promulgation of Implementation Plans; New Mexico; Federal Implementation Plan for Interstate Transport of Pollution Affective Visibility and Best Available Retrofit Technology Determination*, 40 CFR Part 52, dated July 2, 2012.

6 M-S-R notes that this flawed legal conclusion was also set forth in NRDC/Sierra Club's July 27, 2012 Response to the July 9 Tentative Conclusions, and copied verbatim into the comments of the California Wind Energy Association and Solar Energy Industries Association.

> *(4) Any investment in an existing, non-deemed compliant powerplant owned in whole or part by a local publicly owned electric utility that:*
>
> > *(A) is designed and intended to extend the life of one or more generating units by five years or more, not including routine maintenance;*
> > *(B) results in an increase in the rated capacity of the powerplant, not including routine maintenance; or*
> > *(C) is designed and intended to convert a non-baseload generation powerplant to a baseload generation powerplant.*

The FSOR addressed the specific question of whether or not "environmental improvements" would be – *per se* – exempted from the EPS as "routine maintenance." In its final form, the regulation includes exemptions for routine maintenance, and in comments on the draft regulation, parties sought clarification from the Commission that expenditures associated with environmental improvements would be included in this category. The Commission concluded, however, that while the regulation was modified to exclude routine maintenance, "*providing a universal exemption for environmental improvements or legal or regulatory obligations contradicts and exceeds the authority granted under SB 1368*." (FSOR, p. 40) The Commission goes on to note that the regulation is neutral in terms of how it treats pollution control technologies, and finds that "*POUs will only be unable to install pollution control equipment if such equipment would extend the life of the power plant by five years or more or increase its capacity by more than 10% and would not concomitantly reduce its greenhouse gases emissions to or below the EPS.*" (FSOR, p. 46[7]) The Commission, therefore, clarified that environmental improvements would not be automatically deemed routine maintenance. The FSOR *did not* go on, as NRDC/Sierra Club allege, to conclude that such expenditures are automatically deemed covered procurements.

The FSOR clarified that if an expenditure that otherwise "is designed and intended to extend the life of one or more generating units by five years or more" or "results in an increase in the rated capacity of the powerplant" ***is*** routine maintenance, it would not be a covered procurement. If, on the other hand, the expenditure is not routine maintenance, the POU must analyze the expenditure under the provisions of Section 2901(j)(4) of the Regulation. Only after this analysis is applied to a prospective expenditure can a determination be made regarding whether or not the item is a covered procurement under the EPS.[8] Regardless of NRDC/Sierra Club's desire to see all environmental improvements characterized as covered procurements, that is simply neither the current law, nor Regulation. Accordingly, NRDC/Sierra Club's

---

7 The final version of the Regulation speaks to expenditures "that results in an increase in the rated capacity of the powerplant" (§ 2901(j)(4)(B)) and investments in a generating unit that results "in an increase of 50 MW or more to the powerplant's rated capacity." (§ 2901(j)(3))

8 If, after a review and analysis of the provisions of § 2901(j) result in a determination that the expenditure is a covered procurement, M-S-R would file, if necessary, a petition under § 2913 for an exemption for covered procurements that are required under pre-existing, multi-party agreements. However, submission of such a petition is wholly separate and apart from the subjects addressed in the context of the M-S-R Resolution and Staff Reports addressed herein.

unsubstantiated conclusion that prospective expenditures associated with the federal mandates are "covered procurements" under the Regulation is legally and factually flawed. It is also utterly unsupported by the record in this proceeding or in 06-OIR-01.

b. NRDC/Sierra Club's Second Allegation

In their second allegation against M-S-R, NRDC/Sierra Club assert, in no uncertain terms, that M-S-R has acted improperly (and in bad faith) before this Commission in the context of its response to the Commission's request for information in the July 9 Tentative Conclusions. This is simply untrue. M-S-R complied with both the letter and intent of the July 9 ruling, and provided information to the Commission directly responsive to the Commission's request.

In the Tentative Conclusions, the Commission "requests that the POUs provide the following information to allow for a better understanding of how investment decisions are made:

• Copies of written procedure and policies for approving expenditures, particularly expenditures relating to non-compliant powerplants.

• A description of the procedure for bringing expenditure or investment requests to the governing body. Explain what threshold point or points trigger submitting a particular investment for governing body approval." (Tentative Conclusions, p. 3-4)

In its July 27 Response,[9] M-S-R provided a narrative of the procedures employed by the Agency, as well as an example of the application of these procedures to an expenditure that was found to be a covered procurement. Accordingly, in its filing, M-S-R, as well as SCPPA and Anaheim, provided the Commission with information that "would allow for a better understanding of how investment decisions are made."

As more fully discussed above, the documents at issue are part of a public agency's processes that are specific to certain bond matters and in compliance with Treasury requirements. Neither the Staff Reports, nor the Resolution, are part of the Agency's decision making process regarding whether or not a prospective expenditure is a covered procurement. As a public agency, M-S-R deliberates on all such matters in an open and public forum. Nothing in those documents addresses M-S-R's deliberations on the potential expenditures, as that issue is not ripe for deliberation at this time. Furthermore, and just as importantly, the documents at issue specifically **do not** bind or commit M-S-R to any expenditures or project approvals. Accordingly, they are not part of the review process associated with EPS-related compliance, but rather – as more fully discussed above – specifically address financing matters. EPS-related compliance determinations are a separate and critical element of M-S-R's review process for consideration of whether to approve or disapprove an expenditures or investments in the SJGS or any other non-EPS compliant baseload generating facility.

---

9 *Southern California Public Power Authority, M-S-R Public Power Agency, and City Of Anaheim Response to Tentative Conclusions and Request for Additional Information*, July 27, 2012 (Joint Response).

As stated in the Staff Report dated May 21, 2012 and titled "*Development of Funding Plans For Potential San Juan Project Environmental Compliance Retrofits*," development of potential funding plans for either project will enable the M-S-R Commission to be informed of the costs and potential means to pay for either installation of facilities or alternate actions regarding compliance with Regional Haze regulations if it is subsequently determined the Agency is compelled under law or contract to undertake such actions. The title of the report specifically notes the uncommitted nature of the potential projects. The document is not intended to be, nor legally can it be construed as, a commitment to approve or fund a project in the absence of specific M-S-R Commission action.

IV. Conclusion

M-S-R appreciates the opportunity to provide the Commission with this information and to clarify NRDC/Sierra Club's presentation of the referenced documents to the Commission and associated disingenuous allegations and misrepresentations. M-S-R is hopeful that in the future, should NRDC/Sierra Club have any questions or concerns regarding the materials they received from M-S-R, or require additional information regarding M-S-R's processes or related operational matters, that they would contact M-S-R directly, rather than submitting documents to the Commission with unsubstantiated assertions. Furthermore, M-S-R wishes to reiterate that as of this date it has not made any determinations as to whether the installation of federally-mandated emission reduction facilities at the SJGS is or is not a covered procurement pursuant to CEC regulation or statute.

If you have any further questions, please do not hesitate to contact me to discuss this further.

Respectfully submitted,

Martin Hopper
General Manager
M-S-R Public Power Agency